MCKINSEY GLOBAL INSTITUTE

IN BRIEF

DIGITAL EUROPE: PUSHING THE FRONTIER, CAPTURING THE BENEFITS

Europe is in the midst of a digital transition driven by consumers, thriving digital hubs, and some world-beating digital firms. But digitisation is also about the extent to which firms and industries invest in, and use, digital. On this count, Europe's digitisation remains uneven whether we look at sectors, companies, or countries. Europe operates below its digital potential, and is dependent on the United States. Digital market initiatives will have large benefits—but more so with a concerted push to expand digital adoption within private and public-sector enterprises.

- MGI's Industry Digitisation Index is the first effort to capture how digitisation is spreading across Europe, compiling dozens of indicators to provide a picture of digital assets, uses, and workers. The index shows that Europe's economy is digitising unevenly, with large variations across sectors and firms. The information and communications technology (ICT) sector is at the digital frontier, measured by the digital intensity of assets, usage, and labour of that sector. Media and finance are close to the frontier, but large, traditional sectors lag far behind. Europe overall operates at only 12 percent of its digital potential.
- There is also enormous variation between Europe's countries. The United Kingdom operates at 17 percent of its digital potential, France at the EU average of 12 percent, and Germany at 10 percent. Countries like the United Kingdom and the Netherlands are net exporters of digital services to Europe, while Italy is a net importer. Country effects explain one-third of the variation in digital capability across Europe, indicating that countries can influence the extent of digitisation within their domestic economy. Sector effects—with the same sectors at the top of each country's digital heat map—explain the remaining two-thirds of variation in digital intensity across Europe.
- Europe underperforms on its digital potential relative to the United States. The European digital frontier, represented by the ICT sector and its digitisation of assets, uses, and labour, is only 60 percent as digitised as the US frontier. Some large sectors, such as professional services, wholesale trade, and real estate, are further behind the digital frontier in Europe than they are in the United States. Europe is a net importer of US digital services, running a digital trade deficit amounting to nearly 5.6 percent of total EU-US services trade.
- Europe's economy is already seeing the early impact of digitisation, with some correlation between productivity growth and digital intensity across sectors. We also find a mixed impact on the labour market, with rapid worker dislocation offset by new ways of working, matching, and acquiring skills. In the United States, we find sectors' digital intensity is correlated with their profit and wage growth. However, these effects are muted in Europe, in part due to the large digital capability gap relative to the digital frontier, both in Europe and the United States.
- Europe has key digital strengths that it can exploit for economic gains. The Digital Single Market could accelerate GDP growth, adding €375 billion to €415 billion each year, and providing a common platform to allow domestic firms to achieve scale. Even this is dwarfed by the GDP impact if laggard firms and sectors became more digitised. For instance, Europe could add €2.5 trillion to GDP in 2025 if laggard sectors were to double their digital intensity; this would boost GDP growth by 1 percent per year over the next decade.
- Business leaders, national and European policy makers, and individuals all have a role to play in accelerating Europe's digital transition. Companies must assess to what extent digital matters to them and how it might transform their business models. They must also adapt their organisations, digitise their operations, and promote open innovation along the way. Governments should be active on three fronts: unlocking investment and access to capital, opening up data flows, and addressing issues surrounding skills and the labour market. Ultimately, they will have to manage the social and economic transition brought by digitisation, including by mitigating its impact on job displacement. Finally, individuals need to develop their skills and embrace the flexibility and new opportunities that digitisation offers them.

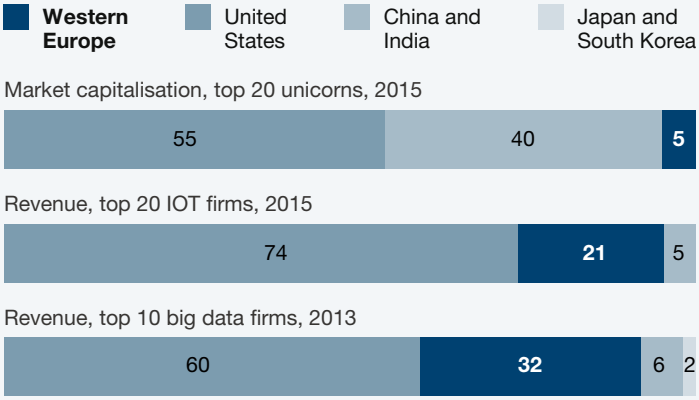
The accelerating digitisation of Europe's economy

There are very few digital "have-nots" left in Europe

- **20%** of enterprises buy cloud services used over the internet
- **43%** of individuals access the internet through a mobile phone
- **83%** of households have access to the internet at home
- **93%** of enterprises have a fixed broadband connection
- **98%** have advanced 3G mobile broadband coverage

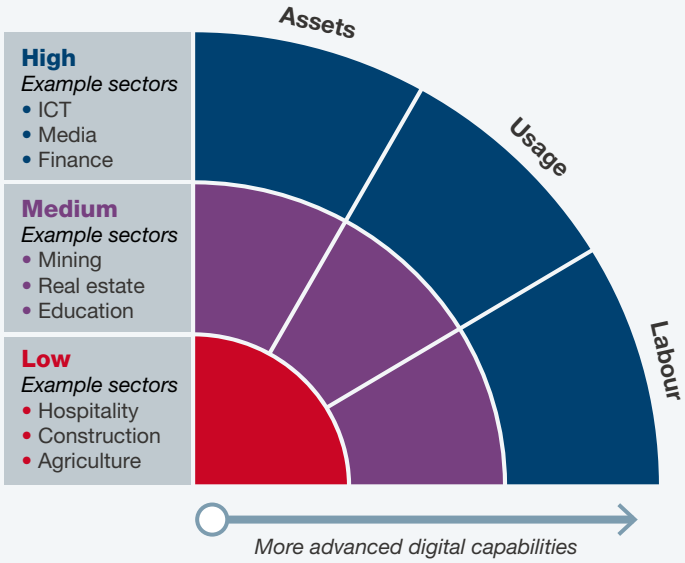
Europe lags in its ability to scale up unicorns, but new digital tech gives reason for optimism

%



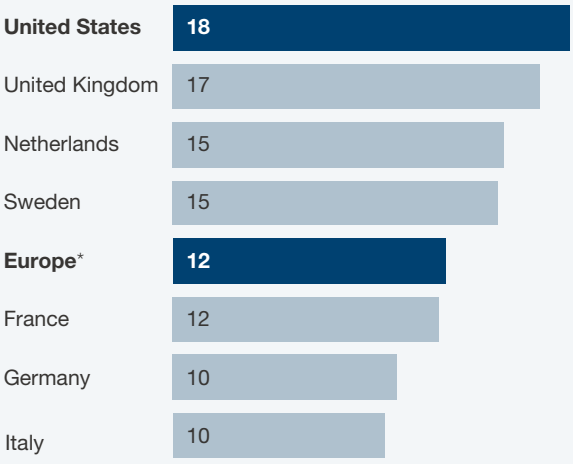
MGI's **Industry Digitisation Index** combines 20 indicators to measure digital assets, digital usage, and digital workers in each sector

MGI's European Industry Digitisation Index



Share of digitisation potential realised

%



* Weighted average of six countries that make up 60% of Europe's population and 72% of GDP

As the digital frontier expands, there is constant pressure to **adapt and evolve**

Companies

- Create new digital business models, and accelerate digital interactions with customers and suppliers
- Prioritise a handful of initiatives to exploit the biggest opportunities
- Be continuously vigilant to spot new technologies, startups, and disruptions
- Leverage new collaborative models such as data-sharing initiatives, crowdsourcing, and virtual collaboration
- Put digital tools in the hands of employees to ramp up productivity

Governments

- Promote the standardisation of telecom networks, regulation standards, and the logistics of e-commerce to create a single digital market
- Increase the flow of venture capital funding
- Promote free flow of data initiatives
- Make digital skills a core part of education curricula
- Develop targeted programmes to fill critical talent shortages such as data scientists

The Digital Single Market could add **€375 billion–415 billion per year to annual GDP** by 2022, and by 2025, digitisation of companies and industries could add **€2.5 trillion to European GDP**

SOURCE: McKinsey Global Institute analysis